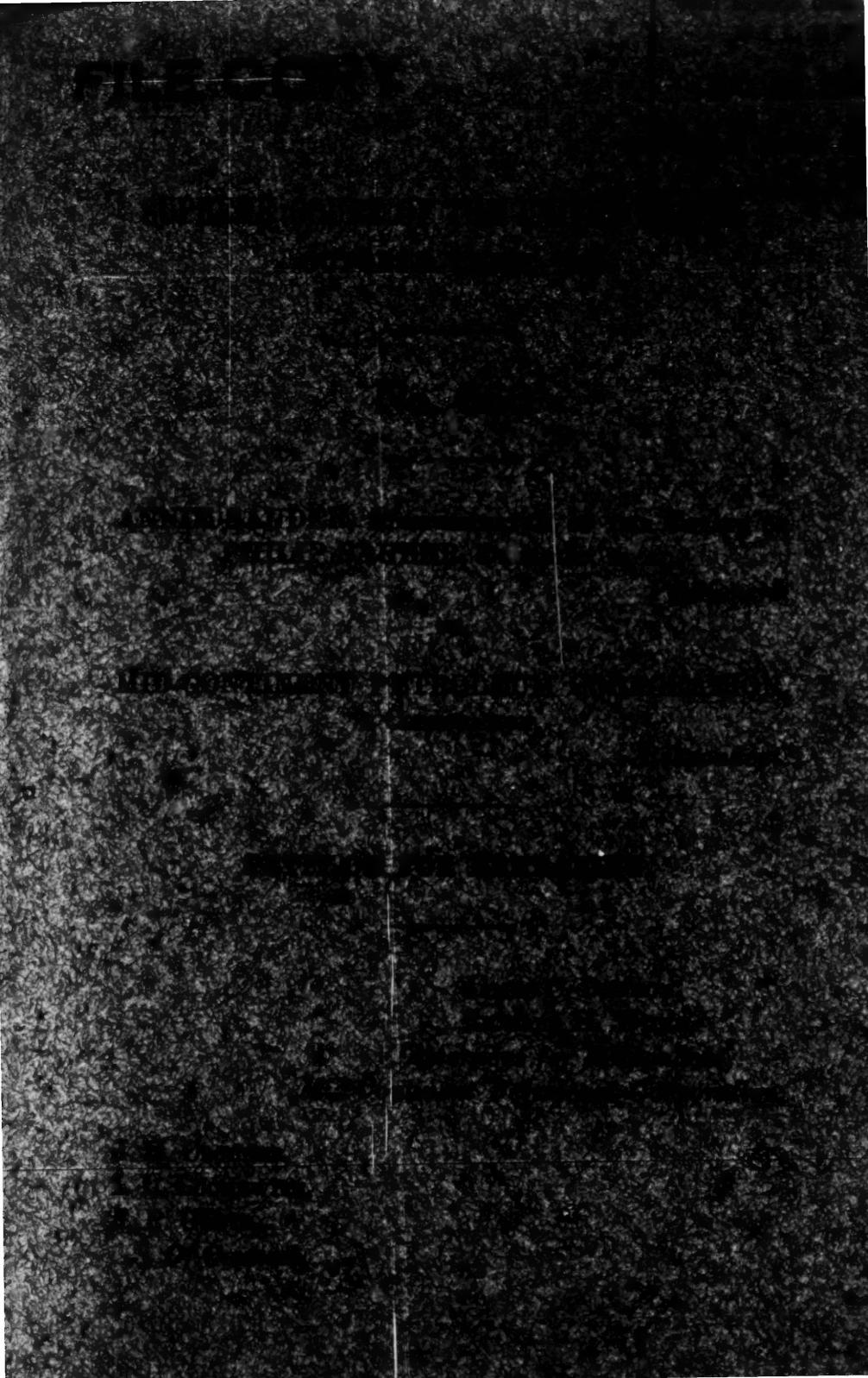

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 660

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED, ET AL.,

Petitioners.

vs.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION,

Respondent.

PETITION FOR REHEARING.

Petition for Rehearing.

Comes now the above named respondent, Mid-Continent Petroleum Corporation, and respectfully presents this, its petition for rehearing of the above entitled cause, and in support thereof respectfully shows:

Reasons for Filing This Petition.

Counsel most respectfully represent that the effect of the decision in this case will be so disastrous to the oil industry in Kansas, and that said opinion is so plainly erroneous that

their duty to their client as well as to the Court impels them to file this petition for rehearing.

Error of the Court.

In the opinion of counsel, the alleged error of the learned Court consists not in the statement of the controlling law, but in the obviously illogical and erroneous application thereof. Or, to state the point differently: after holding as a matter of law according to the long established rule laid down in *Brewster* v. *Lanyon Zinc Company*, 140 Fed. 801, 810, 814, that respondent could not be required to drill a well that will not pay, the Court turns around and requires respondent to drill such a non-paying well.

Furthermore, the Court seems to have overlooked or ignored these controlling facts:

(1) That the term of respondent's oil and gas lease ran for "Ten Years from date hereof, and as long thereafter as Oil or Gas can be procured thereon in paying quantities, * * *" (Record page 6);

(2) That said lease further provides "if Oil or Gas be found on these premises by said second parties, all rights, benefits and obligations secured hereby shall continue so long as either can be procured in paying quantities" (Record page 7);

(3) That at all times subsequent to the drilling and completion of said two wells by respondent on the leased premises, said wells have continued to produce Oil in paying quantities (Record page 34);

(4) That this action is a suit in equity to cancel said lease, and that the burden was on petitioners to allege affirmatively and approve by a preponderance of the evidence that

respondent had breached some express or implied covenant of said lease;

(5) That under the rule of law laid down by the decision in *Brewster* v. *Lanyon Zinc Company, supra,* which is sustained by the opinion of the Court in this case, there was no obligation at law or in equity resting upon the respondent to drill an additional well on the leased premises, unless the respondent could drill a paying well, or unless a reasonably prudent operator would drill an additional well under the same or similar circumstances;

(6) That the petitioners in this case have wholly failed to allege the existence and breach of such a covenant, and have wholly failed to introduce any evidence tending to show a breach by respondent of any duty to drill an additional well; and that notwithstanding such failure of petitioners to allege affirmatively and prove by evidence that respondent has breached any express or implied covenant of the lease, the respondent has affirmatively shown by uncontradicted evidence that a paying well could not at this time be drilled on the leased premises, and that no reasonably prudent operator would at this time drill an additional well thereon.

Question Involved.

The question of law for decision is whether under respondent's lease and the evidence before the Trial Court there was any obligation to drill an additional well upon the lands involved. And this question is first, last and all the time dependent upon the question of fact whether or not it would have paid, or been profitable to, respondent, to drill another well. If it would have paid or been profitable there was an implied obligation to drill it. If it would not have paid, or been profitable there was no obligation to drill it.

The Applicable Law.

The Court in its opinion by Mr. Justice Roberts states the applicable law correctly. We quote the following from the opinion and only ask the Court to analyze and apply the same to the uncontradicted evidence, to-wit:

> "• • • With respect to a lease quite similar in its provisions it was said in *Brewster* v. *Lanyon Zinc Company*, 140 Fed. 801, 810, 814:
>
> " 'The implication necessarily arising from these provisions—the intention which they obviously reflect—is that *if*, at the end of the five-year period prescribed for original exploration and development, oil and gas, one or both, had been found to exist in the demised premises in paying quantities, the work of exploration, development, and production should proceed with reasonable diligence *for the common benefit of the parties*, or the premises be surrendered to the lessor. (Italics ours.)
>
> " 'The object of the operations being to obtain a benefit or profit for *both lessor and lessee*, it seems obvious, in the absence of some stipulation to that effect, that *neither is made the arbiter of the extent to which or the diligence with which the operations shall proceed, and that both are bound by the standard of what is reasonable.*' (Italics ours.)
>
> "After commenting on the fact that *the lessee is not required to carry the operations on beyond the point where they will be profitable to him, even though some benefit to the lessor will result*, the Court adds: (Italics ours.)
>
> " 'Whether or not in any particuler instance such diligence is exercised depends upon a variety of circumstances, • • • *Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required.*' " (Italics ours.)

As before stated, the above is undoubtedly a true and correct exposition of the applicable law.

Application of the Above Law to the Uncontradicted Evidence.

With such a clear, concise and sound enunciation of the law it is incredible to us that the Court could have reached the conclusion that it did.

Bearing in mind that "the lessee is not required to carry the operations on beyond the point where they will be profitable to him, even though some benefit to the lessor will result," which is but another way of saying that the lessee, after discovery by him of oil or gas in paying quantities, is not impliedly obligated to drill an additional well, when it would probably not pay so to do, we would call the earnest attention of the Court to the state of the record:

1. The petitioners introduced absolutely no evidence that there was any drainage by wells on adjoining lands.

2. The petitioners introduced absolutely no evidence that it would pay respondent to drill an additional well upon the lands involved.

3. The petitioners introduced absolutely no evidence that they could get any one to drill an additional well on said lands or that they themselves were willing to do so.

4. The petitioners introduced absolutely no evidence that they had been or would be able to sell a new lease to anyone.

Notwithstanding the above, and also notwithstanding the burden was upon the petitioners to allege and to prove by competent evidence that it would pay the respondent to drill an additional well on the lands involved, Summers Oil and Gas, pp. 434-435; (*Goodwin* v. *Standard Oil Co.*, 290 Fed. (8 C. C. A.) 92; *Orr* v. *Comar Oil Co.*, 46 Fed. (2d) (10 C. C. A.) 59; *Smith* v. *McGill, et al.*, 12 Fed. (2d) (8 C. C. A.) 32; *Cosden Oil Co.* v. *Scarborough*, 55 Fed. (2d)

(5 C. C. A.) 634, 639; and *Brewster* v. *Lanyon Zinc Co.*, 140 Fed. (8 C. C. A.) 801), the respondent, as evidence of its good faith, established by the wholly uncontradicted evidence of three experienced oil men and one geologist: (1) that there was no drainage by wells on adjoining premises (2) that it would not pay the respondent to drill an additional well upon said premises; and (3) that no reasonably prudent operator would drill such well.

Mr. Justice Roberts, referring to the witnesses of respondent, who, by the way, were the only witnesses in the case, said: "These witnesses testified that in their judgment the geological formation, and the experience with wells drilled on nearby lands, made it so unlikely that oil would be obtained as to justify a prudent operator in abstaining from drilling additional wells on the Sauder tract."

Most certainly under this state of the record the Court has either failed to apply the law announced by it, or else has misapplied the same.

Mr. Justice Roberts, referring to the findings of the District Judge, said: "He summarized the evidence as to drilling on adjacent territory and found that there was *some probability that damage was being done to the leasehold through drainage by wells on adjoining properties. He was unable to decide the question of the likelihood that additional wells on the Sauder tract would produce oil or gas in paying quantities and held that in the state of the proofs nothing but exploration and positive tests by drilling could settle the controversy.*" (Italics ours.)

If the evidence was such that the District Judge was unable to decide therefrom whether it would pay to drill an additional well, it was his duty then to dismiss the petitioners' bill, because the burden was upon the petitioners to prove by competent evidence that it would probably pay to drill such well.

The statement of the Trial Judge that "nothing but exploration and positive tests by drilling" could determine whether or not an additional well would pay is merely a statement of what everyone with but a meagre familiarity with the oil and gas industry knows to be a fact. Likewise, no physican can guarantee a cure. Even lawyers are unable to conscientiously assure their clients victory. However, the experience of oil and gas operators and the scientific knowledge of geologists are such as to justify them in giving their opinions as to whether a paying well can be drilled at a particular location, and that is the best proof, if not the only proof, of which the matter is susceptible. *Howerton, et al.* v. *Kansas Natural Gas Co.*, 82 Kan. 367, 108 Pac. 813, 814, 815; *Julian Petroleum Corp.* v. *Courtney Petroleum Co.*, 22 Fed. (2d) (9 C. C. A.) 360, 362, 363. Certainly no judge, unless perchance he has the qualifications of a geologist or an experienced oil and gas operator, can say whether or not a given well would pay. And, if because the actual drilling of a well is the only way of absolutely determining whether or not it will pay, the lessee must actually drill and thus determine the matter, all of the decisions involving the instant question amount to nothing.

In *Cosden Oil Co.* v. *Scarborough*, 55 Fed. (2d) (5 C. C. A.) 634, 636, the court said: "Plaintiff pleaded, its testimony established, and the court found, that there was no way to tell in that territory whether oil and gas could be profitably produced *without drilling for it.* * * * Plaintiff offered no testimony of any person that a reasonably prudent operator, having in mind the interests of both lessor and lessee, would, in the exercise of due diligence," drill a well on the premises involved. And said court therefore held that the plaintiff's showing was wholly insufficient to justify a cancellation of the lease involved, or any part thereof.

With reference to the finding of the trial judge "that there was some probability that damage was being done to the leasehold through drainage by wells on adjoining properties," it is sufficient to say that there is absolutely no evidence to justify such finding and all of the evidence on the subject is emphatically to the contrary.

Mr. Justice Roberts seems to think that unless the petitioners are granted the relief prayed for the respondent will be able to hold its lease "for an indefinite period," without drilling any additional well. Such, however, is not the case, for when the lease ceases to produce oil in paying quantities—whether in one or twenty years—it by its own provisions terminates. And if in the future, before respondent's lease terminates, it would pay to drill an additional well or wells, respondent must drill the same, upon pain of cancellation of its lease.

The court, we think, reaches an erroneous conclusion with respect to the respondent's evidence to the effect that it had no *present intention* of drilling an additional well upon the premises involved. If, as the evidence clearly establishes, it would not pay to drill such well, the respondent, under the authorities, is justified in entertaining such intention and would probably be foolish to entertain any other. *This does not mean that in the future, and before its lease terminates, respondent will not drill an additional well or wells. If future events, regardless of what they might be, justify drilling same, it will do so; in fact, it will be required to.*

If it will not pay respondent to drill an additional well upon the premises involved, the mere lapse of time since the drilling of the last well, the amount of undeveloped acreage or the fact that respondent has no present intention of drilling an additional well affords no justification for cancelling its lease. To do so would nullify the lease—the solemn contract of the parties—which this Court has

no power to remake, in the absence of fraud, accident or mistake, because it provides emphatically that it shall continue, as to the whole of the leased premises, and not any particular part thereof, upon the discovery of oil or gas in paying quantities, as long thereafter as either can be produced in paying quantities, whether it be one or fifty years. *Brewster* v. *Lanyon Zinc Co.*, 140 Fed. 801, 807, 808; *Fisher* v. *Crescent Oil Co.*, 178 S. W. (T. C. A.) 905, 906, 907; *McCallister, et al.* v. *Texas Co.*, 223 S. W. (Tex. Civ. App.) 859, 862, 863; *Duke* v. *Stewart*, 230 S. W. (Tex. Civ. App.) 485; *South Penn Oil Co.* v. *Snodgrass*, 76 S. E. 961, 963; and *Gypsy Oil Co.* v. *Cover, et al.*, 78 Okla. 158, 189 Pac. 540, 544. It is admitted that oil is being produced from said premises in paying quantities.

The court says that respondent "has held a half section for seventeen years without drilling of an exploratory well." The second well drilled by respondent upon the lands involved was drilled in January, 1922, and this suit was instituted June 27, 1930, and while it is an immaterial circumstance, the period of delay involved is approximately 8½ years. Furthermore, the primary term of the lease involved is ten years, which expired June 6, 1926, approximately four years before the commencement of this action, and during that ten years the lease did not require the lessee to drill any well, unless possibly in the case of the implied obligation to offset any paying well drilled on adjoining premises, provided the lessee paid the lessors an annual rental of $1.00 per acre. The first well was not drilled until November, 1921, approximately five years after the date of the lease, and presumably during this five years the lessors were paid the annual rental of $360.00.

None of the authorities cited in the court's opinion supports the conclusion reached herein. *Brewster* v. *Lanyon Zinc Co.*, 140 Fed. 801, involved the consideration of a de-

murrer to the plaintiff's petition, and the Circuit Court of Appeals, at page 815, said : "The necessary inference from what is stated is that *further exploration and development would have been profitable to the lessee,* as well as beneficial to the lessor." Then the court, at page 820, concludes that "the lessor will be entitled to relief *only* in the event that the case made upon the hearing shall be, as is that made by the amended bill." In five of the nine cases cited in note 2 to Mr. Justice Roberts' opinion, *Becker* v. *Submarine Oil Co.,* 55 Cal. App. 698, 204 Pac. 245; *Goodwin* v. *Standard Oil Co.,* 290 Fed. 92; *Austin* v. *Ohio Fuel Oil Co.,* 218 Ky. 310, 291 S. W. 386; *Indiana Oil, Gas & Development Co.* v. *McCrory,* 42 Okl. 136, 140 Pax. 610; and *Phillips* v. *Hamilton,* 17 Wyo. 41, 95 Pac. 846, the courts refused to cancel the leases involved, either in whole or in part, and specifically held that unless it would pay the lessees to drill additional wells there was no breach of the implied obligation to further develop, regardless of the amount of acreage covered by the leases. In one of these five cases, *Becker* v. *Submarine Oil Co., more than nineteen years had elapsed since the drilling of the last well,* but the court held that this was not sufficient, in the absence of proof that it would have paid to drill additional wells, "to establish a lack of reasonable diligence." In one of the four cases in which the plaintiff prevailed, *Daughette* v. *Ohio Oil Co.,* 263 Ill. 518, 105 N. E. 308, the court found that the lessee could have profitably drilled other wells on the leased premises. In another one of said four cases, *Prince* v. *Standard Oil Co.,* 147 La. 283, 84 So. 657, the evidence failed to disclose whether it would pay to drill additional wells, for the lessee took the position that it was the sole arbiter as to the extent of development. However, in said case the court announced the doctrine that the lessee was not bound to drill wells which would be unprofitable to it, even though they would result in a benefit to the lessor. In another of said cases,

Texas Co. v. *Ramsower*, 7 S. W. (2d) (Tex.) 872, the lessee apparently made no contention that oil could not be discovered in paying quantities in additional wells. Said action was one for damages for drainage, and the lessee defended on the ground that delay rentals paid to the lessor justified it in failing to protect from drainage. The fourth case, *Jennings* v. *Southern Carbon Co.*, 73 W. Va. 215, 80 S. E. 368, was decided in favor of the lessor on a demurrer to his bill of complaint, which alleged that the lessee had fraudulently refused to drill an additional well and was fraudulently draining gas from under the leased premises through wells on adjoining premises. The demurrer admitted these allegations and the Appellate Court held that the demurrer should be overruled and the case sent back for trial. *In all of the aforesaid cases the courts clearly held that there is no breach of the implied obligation to further develop, save and except where it would pay to drill additional wells.*

All of the authorities clearly establish:

1. That during the primary term of a lease such as is involved herein, the lessee, if he pays the stipulated annual rental for the privilege of deferring the commencement of a well from year to year, cannot be required to drill any well, unless possibly a well offsetting one on adjoining premises. However, if the lessee would have this lease continue beyond the primary term, it is imperative that he discover oil or gas in paying quantities during such term.

2. That if, under a lease like the one involved, oil or gas is discovered in paying quantities during the primary term of the lease, then the lease provides, whether wisely or unwisely from the lessors' standpoint, that it shall continue in full force and effect as to all of the leased premises, and not any particular part thereof, as long as oil or gas is produced in paying quantities, whether it be one or fifty years.

3. That, of course, during the whole of the life of such a lease, the lessee must perform all of the express obligations contained therein, but there is no claim in the case at bar that the respondent has ever breached any of the express obligations of its lease.

4. That, upon the discovery of oil in paying quantities during the primary term of such a lease, the lessee is required to drill such additional wells, and only such additional wells, as a reasonably prudent operator would drill. However, to use the language of Mr. Justice Roberts, "he is not required to carry the operations on beyond the point where they will be profitable to him, even though some benefit to the lessor will result," or, in other words, he is not required to drill any additional well, unless it would probably pay. This is the limit of the implied obligation sought to be applied in this case.

Therefore, as a matter of law, logic and equity, it follows that if, under such a lease as is involved herein, oil or gas is discovered in paying quantities during the primary term thereof, and the lessee violates none of the express obligations of his lease, and drills such additional wells as a reasonably prudent operator would drill, refusing, however, to drill any well or wells which would probably not pay, his lease continues as to the whole of the leased premises, and not any particular part thereof, as long as he is able to produce oil in paying quantities from the well or wells drilled by him, whether it be one or fifty years.

Applying the above to the case at bar:

1. Oil was discovered by the respondent in paying quantities during the primary term of its lease.

2. At all times subsequent thereto respondent has been and still is producing oil in paying quantities.

3. Respondent has breached none of the express obligations of its lease.

4. And, under the uncontradicted evidence and the rule announced by the opinion herein, the respondent has never to the present time been obligated to drill an additional well upon the leased premises, because all of the evidence is that no reasonably prudent operator would have drilled such well, and to require it to drill same would, under the uncontradicted evidence, be requiring it "to carry the operations on beyond the point where they will be profitable to him."

The error of the opinion of the court is particularly exemplified in its directions to the trial court to cancel the undeveloped portion of the involved lease, unless within a reasonable time respondent drills an additional well thereon, when, under the uncontradicted evidence before the court, no reasonably prudent operator would drill such well, and it would probably not pay so to do.

Probably the court is confused by the lapse of time since the drilling by respondent of its second well upon the premises involved, and the amount of undeveloped acreage, but under the rule of law announced by the court, all such questions as the lapse of time, the amount of undeveloped acreage, the number of wells drilled in the vicinity of a lease, their proximity to the lease, the amount of oil or gas produced therefrom, and whether such wells are draining oil or gas from under the leased premises, are merely incidental questions and cut no figure at all, save and unless they throw light upon or tend to solve the primary or ultimate question, namely, whether or not it would pay to drill an additional well. In other words, if it would not pay to drill an additional well, none of these incidental matters affords any justification whatsoever for the cancellation of the lease, for to do so would amount to scrapping the solemn contract of the parties. *The time element does not enter*

into the matter until it first becomes a fact that it would pay to drill an additional well, and then such well must be drilled within a reasonable time thereafter.

Speaking of the implied obligations to further develop, the court, in *Hall, et al.* v. *South Penn Oil Co. et al.*, 76 S. E. (W. Va.) 124, said:

> "The number and location of wells, requisite to the performance of this covenant, depend upon the character of the leased territory. *The area of the lease does not determine the number, nor is their relation to one another governed by any fixed rule.* Whether, after the discovery of oil or gas, by means of the initial or experimental well, there is a duty to sink additional wells, depends upon the probability, arising from the circumstances surrounding the property, that an additional well or wells will be profitable to the lessee. He is under no duty to operate it at a loss to himself to make the premises profitable to his lessor. It is only under circumstances indicative of mutual profit—profit to lessee as well as lessor—that the duty to operate devolves."

Many years of practice, devoted principally to the study and application of oil and gas law, convinces us that the views herein expressed are elementary to those familiar with the subject; and we most earnestly believe that this petition should be granted.

Respectfully submitted,

JAMES C. DENTON,
RICHARD H. WILLS,
Attorneys for Respondent,
Mid-Continent Petroleum Corporation.

J. H. CROCKER,
I. L. LOCKEWITZ,
J. P. GREVE,
Of Counsel.

CERTIFICATE OF COUNSEL.

We, James C. Denton and Richard H. Wills, attorneys for the respondent, Mid-Continent Petroleum Corporation, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

JAMES C. DENTON.
RICHARD H. WILLS.

(4994-C)